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Testimony of Chaaron Pearson
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The Pew Charitable Trusts

Financial Liability Reform Committee
September 20, 2017

Good afternoon, mister chairman and members of the committee. Thank you very much for this invitation. My name is Chaaron Pearson and I'm a senior manager with The Pew Charitable Trusts' economic development tax incentives project. For those of you unfamiliar with Pew, Pew is a public charity driven by research to help solve today's most challenging problems. Working with partners and donors, Pew conducts fact-based research and rigorous analysis to improve policy, inform the public and invigorate civic life.

Pew partners with officials and stakeholders at the local, state, national, and international levels of government to achieve these goals. Our work is broad, ranging from food safety to criminal justice reform and children's dental health, and most relevant to you all today, addressing state fiscal and economic issues.

The project that I manage has been studying tax incentive evaluation since our first report was released in 2012. In late spring, this year, we released our first national assessment of tax incentive evaluation processes in five years. What we found was that far more states are evaluating incentives with far more rigor than they were doing so just a few years ago. These evaluations are helping states to identify incentives that are working well and reform those that are not.

Lawmakers across the country are looking for ways to create jobs, raise wages, and help the local economy thrive over the long-term. Incentives, which include tax credits, exemptions, deductions, as well as grant and loan programs are some of the primary tools that states use to achieve each of those goals. Incentives are also major budget commitments. Economist Tim Bartik of the Upjohn Institute in Kalamazoo, one of the leading national authorities on business incentives, recently estimated that incentives cost states and localities $40 billion a year.

Given the importance of tax incentives for both state budgets and state economies, it's vital that lawmakers know how well these policies are working and how they can be improved. Regular, rigorous evaluation is a proven way to ensure that tax incentives and other tax expenditures are serving the needs of your budget, economy, and taxpayers. Evaluations have provided reliable information on the economic impact of incentives, including the extent to which they're successfully influencing business

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behavior. These studies have also uncovered flaws in the design or administration of incentives and have recommended improvements.

But the important data that evaluations provide has not always been available. In fact, until recently lawmakers across the country have often lacked any high-quality information on the results of incentives. In many states, incentives have been evaluated inconsistently or superficially, if they have been studied at all. One reason why is that in many states, incentives do not need to be reconsidered with each new budget. Instead, many were created as permanent parts of state code. So while lawmakers regularly debate spending for education, health care, transportation, and other government functions, incentives often have not been part of the conversation.

Thankfully, that's changing. Since the start of 2012, more than 20 states have enacted laws either requiring evaluation of tax incentives or improving existing evaluation requirements. In 2015 and 2016 alone, 13 states approved such laws. This progress has come about largely because lawmakers are demanding better information. In almost every case, evaluation legislation has received strong bipartisan support. These bills have brought together both supporters and skeptics of incentives, who agree on the need for better information.

Through our research, Pew has identified best practices for evaluating tax incentives effectively. Specifically, we recommend that states take three steps, which together make it more likely that lawmakers have consistent high-quality information on the results of their tax incentives and that they'll use that information to improve the effectiveness of those programs.

The first step is to make a plan. Lawmakers need to put processes in place to regularly evaluate the results of major tax incentives. The second step is to measure the impact. High-quality evaluations carefully assess the results of incentives for the state's budget and economy. Finally, the third step is to inform policy choices. Lawmakers are more likely to use evaluations to improve incentives when states have a formal process that ensure lawmakers will consider the results.

The process looks different in every state. In our recent report, How States Are Improving Tax Incentives for Jobs and Growth, we gathered and analyzed tax incentive evaluations and other state documents and interviewed state officials and other experts from all 50 states and the District of Columbia. We found that there were ten states that were leading the way and had well-designed plans for regular reviews, experience producing quality evaluations, and a process for informing policy choices. An additional 17 states and D.C. are making progress in this area. Many of these states have approved laws requiring evaluation recently and are working on implementation.

Despite the impressive progress states have made over the last five years, all states still have room to improve. At the same time, even states that are trailing behind the leaders have taken some initial steps toward regular, rigorous evaluation of tax incentives such as collecting and reporting data on incentives and conducting one-time evaluations.

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I'd like to discuss more detail about each of the three steps I mentioned and give you some examples of how states have implemented them. The first step is to make a plan. The state laws that require evaluation of tax incentives also typically include decisions about the details of the process.

One key decision is who will conduct the analysis. The ideal evaluation office has several key traits. It has a non-partisan, independent perspective, relevant expertise, and authorization to make recommendations about policy.

The most common approach is to use legislative program evaluation or audit options. There are also other options. Indiana uses legislative fiscal staff. Oklahoma has had success contracting with a consulting firm to perform the evaluations. Mississippi evaluations are conducted by a university research center. Evaluation processes succeed when lawmakers think through who in their state has both the capacity to produce good evaluations and the needed independent perspective.

Lawmakers also need to set a review schedule. Many evaluation laws ensure that incentives will be studied on a rotating multi-year cycle, with different groups of incentives reviewed each year. Evaluating all major economic development incentives every three to six years is typical. Using this approach, both evaluators and legislators can study a subset of incentives in detail each year.

Often, the schedules are organized around the goals of incentives. A state might examine all of its incentives that are intended to help distressed areas in the same year, for example. That way, policymakers can consider which approaches are most effective.

States such as Oregon and Washington have also ensured that incentives are evaluated prior to statutory expiration dates. That way, when lawmakers have to make a decision on whether incentives will continue and in what form, they will have objective information to help guide their actions.

Once a plan is in place, the next step is for the evaluations themselves to measure the impact of incentives. Evaluations typically include information on the results of incentives for both states' budgets and economies. High-quality evaluations don't stop at crunching numbers. They explain the findings and place them in context.

If an incentive is proving to be an ineffective tool for job creation, for example, the program could be poorly designed or poorly administered. By carefully examining economic results, design, and administration of incentive programs, states have drawn valuable conclusions about what is and isn't working. Here are examples of evaluations that have done just that.

One of the most important questions when measuring the impact of an incentive is what happened because of the incentives and what would have happened anyway. More and more evaluations around the country are coming up with thoughtful ways to answer that question. For example: Indiana did an evaluation of a tax deduction for certain energy efficiency products. One of the most important questions when measuring the impact of a tax incentive is what happened because of the incentive and

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what would have happened anyway. What the evaluation showed is that installing one of these energy efficiency products typically costs 900 dollars. The tax deduction saved 21 dollars off of those 900 dollars or 2.33 percent. The evaluation argued that the tax deduction just didn't make a big enough difference to be an effective tool to encourage installations of these products. Lawmakers agreed with the evaluation and ended the tax deduction.

In Alabama authors of their evaluation study identified a variety of criteria that help determine the success of incentive programs. The authors of this study identified a variety of criteria that help determine the success of incentive programs, such as efficiency, transparency, simplicity, if the program is targeted, and certainty (meaning, did the incentive have a defined impact on budget and program participants). Then, they graded incentives on the extent to which they fulfilled these criteria. This approach helped them identify potential improvements. The authors found that the Historic Rehabilitation Tax Credit had generally worked well. But they also pointed out that the program provided incentives to projects on a first-come, first-served basis. They argued that the program would get better results if Alabama started assessing projects based on objective criteria. That way, Alabama could make sure the deserving projects with the strongest economic benefits received incentives. The Historic Rehabilitation Tax Credit had lapsed in 2016, but, based on the strong grade, lawmakers restored it earlier this year. They also modified the program to include an assessment process for projects that apply, just as the evaluation had recommended.

North Dakota is a great example of how states are using evaluations to improve the effectiveness of their incentives. In 2015, they tasked an interim committee with evaluating incentives. In the first round of evaluations, the committee found that some incentives were working well, allowing lawmakers to invest in those programs with confidence. The panel also uncovered what lawmakers see as a potentially serious flaw in the state's Angel Fund Investment Tax Credit: Program rules have allowed angel funds to invest in out-of-state companies, many of which have no economic impact in North Dakota. To fix this problem, lawmakers added new protections to encourage in-state investments.

That type of change can make a real difference. Earlier this year, Oregon reported that the state was saving hundreds of millions of dollars as a result of its evaluation process. Those savings did not come about primarily by eliminating incentives. Instead, Oregon has worked to reform the programs, so that they cost less and provide a greater return on the state's investment.

As these examples show, in state after state lawmakers are using the findings of high-quality evaluations to improve the effectiveness of economic development tax incentives. As a result, evaluations are helping states achieve better outcomes for their budgets, businesses, and workers.

Thanks so much for your time and attention. I'm happy to answer any questions.